Analysis of Pakistan’s Debt Situation: 2000-2017[1]

Ishrat Husain

First, let us begin by clarifying the definitions and concepts that are used frequently and have created a lot of confusion among the laymen’s mind.

Pakistan’s total debt and liabilities (TDL) consist of public debt and private debt. Total stock of outstanding debt and liabilities on June 30, 2017 stood at 79% of GDP. Of this, Gross Public Debt accounted for 85% of the total outstanding or 67.2% of GDP. The remaining 15% is the private debt mostly to borrowers outside the country, for which the government has no fiscal obligation, but the SBP has to provide foreign exchange to service this debt. Within the gross public debt, the government’s share was predominant – almost 92% while the balance was owed by the public enterprises but guaranteed by the government. Borrowing from IMF is also included in gross public debt, although it is a liability of the SBP.

The total debt and liabilities is made up of borrowings in Rupees – from SBP, banks, National Savings schemes, prize bonds, Sukuk etc. and borrowings in foreign currency – from multilateral institutions such as the World Bank, ADB, IDB, bilateral countries or international financial markets in the form of Eurobonds or Sukuk. The Rupee denominated borrowing is termed as Domestic Debt, while the foreign currency denominated borrowing is called External Debt.

It is not advisable to examine the debt burden in terms of absolute amounts or per capita terms. The correct way to access is to use various indicators that relate total Public Debt stock to national

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income, exports, revenues, total foreign exchange earnings, foreign exchange reserves, and total revenues.

A more important and relevant way is to look at the total debt servicing capacity, especially that of External Debt. As this has to be paid in foreign exchange, the capacity is very much dependent on current and future earnings of foreign exchange and the level of reserves. This requires careful examination of the tenor (medium or long term, short term) element of Concessionality, interest rate, grace period of each loan contracted.

The risks of Domestic Debt are quite different from those of External Debt. Lumping Domestic and External Debt together is analytically incorrect. While both create debt servicing liability for the budgetary purposes and therefore affect the fiscal balances the risk profiles of the two are quite different. Domestic Debt has to be paid in rupees which can be printed or the Central Bank can acquire those obligations on its balance sheet by creating reserve money. It involves creating possible inflationary pressures but there is no risk of default which is a real threat in case of foreign currency denominated debt. Countries that have suffered debt crisis have faced solvency and liquidity risks in servicing their foreign currency loans.

Risks arising in case of Domestic Debt are roll over risk, interest rate risk, and crowding out of private sector credit.

So we would therefore largely focus the rest of the discussion on the External debt and liabilities and its servicing. What are the early warning signs or indicators that show the build up of vulnerabilities?

- What is the composition of External Debt i.e the break up between Medium and Long term (MLT) and short term (ST) loans? If it is heavily dominated by MLT loans then the risk is relatively lower ,

- What are the ratios of External Debt and Liabilities (EDL) to GDP, Exports , Foreign Exchange Earnings and Official reserves? If these ratios are on a downward moving path over time there is not much cause for alarm
- How much is the element of concessionality in the stock of the EDL i.e. the average interest rate, years to maturity, proportion of fixed rate loans? The higher is the element of concessionality the stronger is the safety valve
- Are the country’s official liquid reserves adequate to cover the short term loans and loans maturing during the year? What is import coverage ratio? Will the demand from both these create pressure on the reserves?
- Is the real rate of interest on loans lower than the real rate of growth of national income?

We now examine the data in Tables I-X to discern the broad patterns, indicators and trends for special attention to public debt. The following conclusions can be drawn .

- External Debt situation was out of control in 2000 when the debt servicing payments due were as high as 290 percent of the official liquid reserves available. Between 2008 and 2008 the debt reprofiling by Paris club, accumulation of official reserves led to an easing of the burden and by 2008 debt servicing payments amounted to only 25 percent of reserves. There was a further pressure in 2013 but it took a turn for better in the next four years raising its ugly head once again in 2018. The rapid depletion of reserves in recent months has created serious concern, as Import growth is quite accelerated and the current account deficit is widening. Total debt servicing obligations have , however, remained at the same level as in

2008 i.e. around 6 percent of GDP and have in fact declined by 1 percentage point(ppt) from 2013.

- Public External Debt is lower in 2017 i.e. 20.7 percent of GDP while it was 27.1 percent in 2008 and 21.4 pct in 2013. About 93 pct of the public external debt falls under the category of Medium and Long term while 7 pct under the short term. Therefore the risk appetite for further short term borrowing to tide over payment difficulties cannot be ruled out as the short term public external debt to SBP reserves ratio is 5.5. Concessional loans still form more than half of the outstanding stock and commercial loans account for only 1.6 percent of the total.

- Total stock of TDL on June 30, 2017 stood at 79 percent of GDP which is 16 percentage points (ppt) higher than 2008 and 6 ppt than 2013. Domestic Debt now accounts for 70 percent of TDL up from 52 pct in 2008 while external debt is down to about 30 pct. Of the TDL, the share of Gross Public Debt was 67.2% of GDP which did not rise at the same speed as the total TDL.(6.8 ppts higher than 2008 and 3.4 ppts than 2013). The real culprit was the private sector debt which rose from 2 percent of GDP in 2008 to 11.5 percent in 2017. It is pertinent to point out that for private debt the government has no fiscal obligation but the SBP has to provide foreign exchange to service this debt. Borrowing from the IMF is also included in gross public debt, although it is a liability of the SBP and has no fiscal consequences.

- A major setback has been caused by stagnation in foreign exchange earnings due to a $ 4 billion drop in export receipts since 2013 .This has raised the EDL to FEE ratio from 121 to

162 in 2017. There has been some growth in exports in last few months but the pace is unspectacular to make a dent. The other element which is picking up is Foreign Direct Investment but that also won't be able to lower this ratio significantly.

- On the fiscal side, almost 24% of government revenues were pre-empted by payments of interest and foreign loan repayments. The average interest rate is down to 6.3 percent with domestic debt being relatively expensive at 8.2 percent.

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It is not advisable to examine the debt burden in terms of absolute amounts or per capita terms. The correct way to access is to use various indicators that relate total Public Debt stock to nominal income, exports, revenues, total foreign exchange earnings, foreign exchange reserves, and total revenues.

A more important and relevant way is to look at the total debt servicing capacity, especially that of External Debt. As this has to be paid in foreign exchange, the capacity is very much dependent on current and future earnings of foreign exchange and the level of reserves. This requires careful examination of the tenor (medium or long term, short term) element of Concessionality, interest rate, grace period of each loan contracted.

The composition of Total Debt and Liabilities has changed over time. Domestic Debt now accounts for 70% of the public debt, up from 50 percent in 2008. The risks of Domestic Debt are quite different from those of External Debt. Lumping Domestic and External Debt together is analytically incorrect. While both create debt servicing liability for the budgetary purposes and therefore affect the fiscal balances the risk profiles of the two are quite different. Domestic Debt has to be paid in rupees which can be printed or the Central Bank can acquire those obligations on its balance sheet by creating reserve money. It involves creating possible inflationary pressures but there is no risk of default which is a real threat in case of foreign currency denominated debt. Countries that have suffered debt crisis have faced solvency and liquidity risks in servicing their foreign currency loans.

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